

**COMMONWEALTH OF MASSACHUSETTS**  
**DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

---

**IN RE DEFAULT SERVICE  
PROCUREMENT, D.T.E. 04-115**

---

)  
)  
)  
)  
)  
)

**REPLY COMMENTS OF ENERGY MANAGEMENT, INC.**

**I.     Introduction**

Energy Management, Inc. (“EMI”) hereby submits comments in response to positions taken at the June 20, 2005, technical conference in the above-referenced docket. EMI is a Boston-based energy company that has been one of New England’s leading independent developers and operators of electrical generation projects. EMI developed a substantial portion of the region’s natural gas-fired combined cycle generation facilities and is now developing the Cape Wind project, which would be the nation’s first offshore wind facility and would generate up to 420MW of clean and renewable energy. Accordingly, EMI is particularly well suited to offer comments as to capital market requirements relative to the financing of the new generation infrastructure needed to maintain system reliability.

**II.    The Massachusetts Electric Restructuring Act of 1997 (“Restructuring Act”) Did Not Relieve Electric Companies from Their Long-Range Planning and Reliability Responsibilities.**

Several parties at the technical conference adopted the position that the Restructuring Act relieved electric companies of their traditional public service duty to assure the long-range adequacy of electrical supply, leaving them as only “wires companies,” with no

responsibility for the reliability of long-term supply. As an initial matter, the Department should unequivocally reject such position as inconsistent with both the plain terms of the Restructuring Act and the needs of the public.

Most importantly, the Restructuring Act did not delete the long-standing provisions of Section 69I of Chapter 164 of the General Laws (“Electric and Gas Companies to File Long-Range Plans or Forecasts Concerning Energy Needs”) and the following provisions of such section remain in effect today:

Every electric company, except municipal corporations authorized to operate a municipal lighting plant under the provisions of sections thirty-four to thirty-six, inclusive, shall file with the department a long-range forecast with respect to the electric power needs and requirements of its market area, taking into account wholesale bulk power sales or purchases or other cooperative agreements with other electric companies, for the ensuing ten-year period. Such forecast shall be filed at least every two years.

\*\*\*

Said forecasts shall include, in such form and detail as the department shall prescribe, the following information:

- (1) A description of all then existing agreements with other electric or gas companies for joint planning or joint forecasting of electric power or gas needs and the purchase or sale of electric power or gas or reserve capacity.
- (2) A forecast of the electric power needs or gas requirements for its market area, taking into account wholesale bulk power or gas sales or purchases, or other co-operative arrangements with other utilities and energy policies as adopted by the Commonwealth.
- (3) A description of actions planned to be taken by the company which will affect capacity to meet such needs or requirements....

M.G.L.c. 164, § 69I. The Restructuring Act did, however, add the following sentence to Section 69I to allow the Department the discretion to provide administrative exemptions from such obligations, but only to the extent that “an alternative process is in the public interest:”

The Department is authorized to exempt any electric or gas company from any or all provisions of this section upon a determination by the department and the siting board, after notice and hearing, that an alternative process is in the public interest.

M.G.L.c. 164, § 69I. Thus, electric companies may be exempted from their statutory duties of long-term supply reliability only to the extent that, and for so long as, the Department, in its discretion deems an exemption to be in the public interest, as previously explained in D.T.E. 98-84/EFSB 98-5:

Following the Electric Industry Restructuring Act of 1997 (“Restructuring Act”), electric companies were no longer responsible for procuring electricity supplies for their customers, except for standard offer and default service. ... However, the Restructuring Act did not relieve electric companies of the obligation to file long-range forecasts under §69I. Instead, the Restructuring Act placed the responsibility for determining the scope of future regulation of electric company planning policy on the Department and Siting Board by amending § 69 to include [the above provision].

DTE 98-84/EFSB 98-5, Hearing Officer’s Request for Comments (August 19, 2002), at 2 (emphasis added). Accordingly, the appropriate question at this juncture is whether a continued and discretionary exemption of electric companies from their long-term supply-related obligations is in the public interest, in light of the currently applicable facts and intervening regulatory developments.

### **III. Exemption of Electric Companies from their Long-term Reliability Obligations Regarding Supply Adequacy is No Longer in the Public Interest.**

#### **A. The Region Now Faces Capacity Shortages.**

Although the Department made a determination in a previous proceeding (D.T.E. 98-84) that, based upon the facts applicable at the time, it was in the public interest to exempt electric companies from their statutory duties regarding long-term supply planning, more recent developments indicate that such an exemption is no longer appropriate. Most importantly, the Department last considered such issue under dramatically different factual circumstances, when

large volumes of new generating capacity were expected to be developed and when restructured electric markets were less fully defined. In contrast, ISO-New England is today providing stark warnings that New England no longer enjoys surplus generating capacity and, in fact, faces serious threats to the reliability of its electric supply, and that needed investment in new generation is not occurring. Indeed, the ISO's most recent public statement warned the region of the coming threat of rolling blackouts:

While electricity use continues to climb—in mid-June we came within a whisker of setting an all-time record—supply has stopped growing. In two to four years, we will not have enough electricity to keep the lights on in the summer. Without new investment, New England could face an energy future much like California's recent past, including frequent power emergencies, and possible rolling blackouts.

\*\*\*

But as New England's economy continues to grow, so does its need for electricity. Demand for electricity will grow by 1.5 percent a year—equivalent to the power produced by one new power plant. Unfortunately, the pipeline for new plants is empty. Moreover, there is a potential for several existing plants to be deactivated, some of which are located in heavy-demand areas, such as Greater Boston.

“New England's Electricity Crisis” by Gordon van Welie, The Boston Globe, Saturday, July 9, 2005 (emphasis added). Recent operating reports of the ISO further indicate that the region's ability to meet its reserve obligations is already in jeopardy, with the ISO's May 2005 Operations Report (attached hereto) projecting that, for the summer of 2005, New England will be 665 megawatts short of meeting its reserve requirements under normal weather conditions, and short nearly 2,300 MW under the hot weather scenario. It is incumbent upon the Department to acknowledge the ISO's warnings as to the growing related threat to supply-related reliability and to reconsider accordingly the wisdom of continuing any discretionary exemption of electric companies from their long-term reliability obligations under Section 69I.

**B. Recent Policy Clarifications by the FERC Further Indicate the Need for the Department to Reconsider Any Exemption of Electric Companies from Their Long-Term Reliability Obligations.**

Recent clarifications by the FERC regarding restructuring policy should also cause the Department to carefully consider any proposal for a continued exemption of electric companies from their long-term statutory duties regarding supply adequacy. In the Devon Power proceedings, FERC Dockets No. ER03-563-030 and EL04-102-000, FERC, in the specific context of the restructured New England markets, explained that it remained necessary for those entities with long-term public service obligations to undertake the long-term capacity procurements required to maintain supply reliability:

ISO-NE has sought guidance on the issue of what entity should bear the responsibility for longer-term capacity procurement and long-term reliability. The Commission addressed a similar issue in the PJM Order. As a general matter, the Commission believes that the market design of the RTO or ISO should be structured to send appropriate price signals and thus provide an incentive for load to procure capacity to meet their long-term requirements. ... However, it is LSEs that have the primary responsibility for longer-term capacity procurement and obtaining sufficient supplies to ensure long-term reliability.

Devon Power LLC, 107 FERC ¶ 61, 240 (2004), ¶ 75 (emphasis added). Upon rehearing and clarification, the FERC further explained that it is the responsibility of the State commissions (in this case, the Department) to specify exactly which entities have the public service responsibility, on behalf of load, for procuring the long-term capacity adequate to serve the public:

Resource adequacy is a matter that has traditionally rested with the states, and it should continue to rest there. States have traditionally designated the entities that are responsible for procuring adequate capacity to serve loads within their respective jurisdictions. ... [W]e conclude that each state should continue to establish policies that determine which entities are responsible for procuring adequate capacity for loads. In those states that permit loads to switch suppliers on a frequent basis and where no one entity may be designated by the states as having the responsibility to procure

capacity for loads on a long-term basis, we will not override the states' decisions on this matter. We will, however, require that the benefits and costs of individual state policies should rest with loads within the state. Thus, the RTO or ISO should have in place operating policies that ensure that loads in states that have procured adequate capacity are not curtailed as a result of inadequate capacity procurement by load serving entities in other states.

Devon Power LLC, 109 FERC ¶ 61, 154 (2004), ¶ 47 (emphasis added). Notably, the FERC reached this conclusion after recognizing comments that wholesale marketers under relatively short-term default service supply contracts have no incentive to enter into the longer-term supply agreements that would be necessary to assure long-term reliability. The FERC noted in particular that “the Maine PUC contends that given the relatively short-term nature of the standard offer contracts, it is difficult to foresee why load serving entities would enter into bilateral contracts with generators that have terms long enough to attract financing” and that “the Maine PUC states that generators need either longer-term contracts or a substantial risk premium before they will be able to voluntarily invest in new capacity.” Id. at ¶ 46.

Thus, the Department should carefully examine any potential extension of the discretionary exemption of electric companies from their long-term reliability duties in light of the intervening clarification by the FERC that (i) it is the duty of the State commissions to identify the entities responsible for long-term capacity procurement sufficient to maintain long-term supply reliability, and (ii) it was never presumed that the requisite post-restructuring investment in generation would occur without long-term procurement. Notably, no one in this proceeding has suggested that any parties other than electric companies would or could realistically assume such long-term public service responsibilities.

**IV. Longer-Term Purchase Agreements by Utilities are Not Inconsistent with the Economic Theory of Deregulation.**

Contrary to several comments raised at the technical conference, requiring electric companies to procure a portion of their wholesale supply requirements (whether for standard offer, last resort or any successor service) on a longer-term basis is in no sense inconsistent with the economic theories of deregulation. To the contrary, as noted above, the recent policy clarifications by the FERC confirm that there can be no presumption that necessary reliability investments will occur absent such long-term procurement. Similarly, Professor William Hogan in his leading deregulation treatise, Competitive Electricity Market Design: A Wholesale Primer (1998), clearly indicated that post-restructuring generation investment would occur only when long-term procurement contracts are in place, and that spot markets alone would not sufficiently incentivize needed investment in generation:

If the generator or customer wants price certainty, then new generation contracts can be struck between a willing buyer and a willing seller. The complexity and reach of these contracts would be limited only by the needs of the market. Typically we expect a new generator to look for a customer who wants a price hedge, and for the generators to defer investing in new plant until sufficient long-term contracts with customers can be arranged to cover a sufficient portion of the requirement investment. The generation contracts could be with one or more customers and might involve a mix of fixed charges coupled with the obligations to compensate for price differences relative to the spot-market price.

Id. at 20 (emphasis added). It was thus presumed from the outset that investment in new generation would not be expected to occur in the absence of long-term procurement contracts.

It is also incorrect to suggest that long-term procurement by electric companies would result in an adverse impact upon the workings of the competitive markets. Indeed, reference to the Massachusetts experience in the restructured retail gas markets indicates a contrary conclusion. Notwithstanding the fact that Massachusetts gas companies have not been exempted from the long-term supply responsibilities under Section 69I and have procured gas

supply and transportation for longer terms, retail gas competition has proceeded successfully, and New England's wholesale gas spot market (*i.e.*, as reflected in the Algonquin Gate Index Price) remains exceptionally liquid and responsive. Further, since natural gas is the marginal fuel for most hours of NEPOOL dispatch, the same Algonquin Gate index (adjusted by a heat rate conversion factor) will in effect set equally responsive electricity prices for the regional market, irrespective of some increment of longer-term procurement by electric companies. There is thus little empirical evidence that would indicate that some degree of longer-term electric procurement arrangements would somehow undermine or adversely affect the responsiveness of the region's electric pricing or otherwise undermine competitive markets.

**V. Federal and State Energy Policies Heighten the Need for Long-term Procurement with Respect to Renewable Energy Projects**

In addition to the foregoing policies supporting the long-term procurement of energy in general, additional Federal and State policies support longer-term procurement in the specific context of renewable energy projects. In this regard, the Department should note the comments raised by the leading public interest advocacy groups in this proceeding (*i.e.*, The Union of Concerned Scientists, Massachusetts Public Interest Research Group, Massachusetts Energy Consumers Alliance, Clean Water Action, and the Conservation Law Foundation) requesting that the Department help fulfill the legislative mandate of the Massachusetts RPS through longer-term procurement practices:

In particular, the failure of state government in general and the Department in particular to foster development of renewable resources through its policies has been part of the cycle of failure. The Department must recognize that long-term contracts are needed for new renewable generation sources to be built. In our recommendations included here and in our initial comments, we call on the Department to address the failures of the current defaults through procurement practices to deliver renewable energy and energy efficiency results that consumers require and deserve, and in so doing, change the cause of failure to become part of the solution.



#### Reply Comments at 4.

The Department should also consider the continuing obligations of electric companies to enter into long-term purchase arrangements with renewable energy providers pursuant to the terms of the Public Utilities Regulatory Practices Act of 1978 and the regulations of the FERC thereunder. In particular, Section 292.304 of the FERC's regulations ("Rates for Purchases") provides that an electric utility's obligation to purchase the output of qualifying facilities ("QFs") shall, at the option of the renewable generator, be either on an "as available" or long-term contractual basis (i.e., priced at the electric utility's avoided cost over the term, as projected at the time the obligation is incurred):

Each qualifying facility shall have the option either:

- (1) To provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or
- (2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either: (i) the avoided costs calculated at the time of delivery; or (ii) the avoided costs calculated at the time the obligation is incurred.

Section 292.304(d) (emphasis added). Thus, longer-term supply procurement by electric companies would be entirely consistent with their continuing obligations to make long-term sales options available to qualifying renewable facilities under Federal Law.

#### **VI. Conclusion**

While the NEPOOL system faces the threat of looming power shortages and blackouts, no party currently acknowledges any public service obligation to address the problem. In light of the clear and continuing warnings from ISO-New England as to the growing crisis in

electrical supply, it is incumbent upon the Department to take affirmative action to assure that the requisite investment in new generation facilities will occur in time to meet the growing supply needs of the public. We thus respectfully request the Department to (i) discontinue the discretionary exemption of electric companies from their responsibilities under c. 164, Section 64I regarding long-term supply, and (ii) direct electric companies to procure portions of their retail supply requirements on a longer-term basis sufficient to provide the financial signals necessary for the requisite capital investment to occur.

Respectfully submitted,

ENERGY MANAGEMENT, INC.

By: \_\_\_\_\_

Its: VP\_\_\_\_\_

Dennis Duffy  
75 Arlington Street, Suite 704  
Boston, MA 02116  
(617) 904-3100, x. 112

Date: July 22, 2005

809078\_1/10435-2